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Making work pay?

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Abstract
The growth of wage supplementation through in-work benefits and tax credits has been one of the most fundamental recent developments in the UK social security system. Broad statements of policy aims such as 'making work pay' and providing 'support for work' are superficially simple and clear. In practice, however, they cover a complex variety of goals and policy instruments. This article outlines the main policy measures introduced since 1997, discusses the different policy goals and highlights some of the major limitations of the current policy approach.

Introduction

Under the Beveridge plan, published in 1942 and implemented after the Second World War, there was almost no provision made for those in employment because the main purpose of social security was to cover people – male breadwinners in effect – for interruptions of earnings due to reasons beyond their control. Thus there were no benefits for working people with the exception of family allowances for second and subsequent children. But since the 1970s – when Family Income Supplement was introduced and housing-related benefits were extended on a national basis – there has been a steady growth in the coverage and costs of in-work financial support. The recent introduction of tax credits has further increased the importance of in-work transfers. The average payment of Working Families Tax Credit in February 2003 was about £86 per week (Inland Revenue, 2003) and by April 2004 there were about 1.6 million families with children receiving Working Tax Credit (Inland Revenue, 2004). Using the social security system – or rather the tax system – to 'make work pay' has become a key policy goal.

Broad statements of policy aims such as 'making work pay' and providing 'support for work' are superficially simple and clear. In practice, however, they cover a complex variety of goals and policy instruments. In this article[1], we explore some of the tensions and overlaps in the way in which this policy goal has been defined in practice in current UK policy. There are three main sections to the article. The first outlines the key policy measures introduced since 1997, noting in particular whether these are targeted at individuals or households. In the second section we argue that there are a number of rather different policy goals being rolled up under the 'make work pay' heading and that these goals may sometimes be in tension with each other. The final section highlights some of the major limitations of the current policy approach.

[1] Based on a paper originally prepared for a Joseph Rowntree Foundation seminar held in London in January 2004.

Measures aimed at 'making work pay'

Here we identify the main fiscal measures aimed at making work pay[2]. These can be divided into two main groups. First there are provisions aimed at making work pay during the transition to work, as summarised in Table 1. These are generally time-limited measures, or are made in the form of lump sum payments, to enable people to manage financially when they start work and have to leave Income Support or Jobseeker's Allowance (JSA). The number and range of these have expanded greatly in recent years; they include various pilot or trial schemes; and some are paid at the discretion of Jobcentre Plus officials (and are therefore not included in Table 1). There are also provisions to 'fast track' claims to forms of ongoing in-work support – to speed up the administration of these new claims, to avoid an overlong gap before receipt of support. In addition to these measures aimed at the transition to work, there are also measures targeted on those in work, and offering ongoing support. Table 2[3] summarises these measures, separately identifying those that are aimed at individual low-waged workers and those that are aimed at low-income families/ households[4] that include someone in work. These are often rather different groups, although they can overlap (as in the case of lone parents, for example).

The individually targeted measures are of three main types: the direct regulation of wage levels via the National Minimum Wage reductions of income tax and National Insurance (NI) contributions and some limited provision of subsidised employment. The National Minimum Wage is the most important of these, in that it sets a floor below which individual wages should not fall. The new system of tax credits is the most important of the non-individually-targeted measures. Working Tax Credit is assessed on the basis of family income and other entitlement conditions which relate to hours of work (at least 16 hours per week for families with children and disabled people and at least 30 hours per week for non-disabled single people and childless couples), and to age (non-disabled single people and childless couples must be aged 25 or over to be eligible). Those working 30 or more hours per week receive a bonus. The income tax system, rather than the social security benefit system, has become the main vehicle for delivering ongoing in-work support. The Treasury has argued that delivery through the tax system makes such support more acceptable because it is thereby associated with rewards from work and universal taxation, rather than with state assistance and selective benefits (HMT, 1998a, 1998b). However, the delivery of Working Tax Credit by employers through the pay packet is now being replaced by direct payments by the Inland Revenue (HMT, 2004), largely it seems because employers were not willing to continue to take responsibility for administering this scheme. But the issue of 'making *more* work pay' – the 'poverty trap' caused when the combination of increased income tax and NI payments and the withdrawal of means-tested in-work support results in high marginal deduction rates – inevitably rears its head when discussing 'make work pay' policies. And for potential second

[2] In this article 'work' means paid employment.

[3] Much of the information in these tables is taken from Brewer et al, 2002 and/or Sutherland et al, 2003. Other information – including the date of implementation and more detail on measures etc – is taken largely from the Social Policy Digest, now on-line as part of the Journal of Social Policy – for subscribers to the Journal, follow the link at www.journals.cambridge.org/jid_JSP. Some items are from the diary of events in *Poverty*, the journal of the Child Poverty Action Group.

[4] Technically, benefit units, that is, the unit of assessment for the benefit or tax credit.

earners, these two issues may often overlap: policies to ‘make work pay’ impact on them as individuals, but policies relevant to ‘making more work pay’ (or not) will also impact on them as a member of a family unit which is increasing its paid work in total.

The measures outlined above in Tables 1 and 2 have all been implemented, although some are/were on a pilot, rather than national, basis. But this is a rapidly developing policy area, and several other measures have been announced more recently, to be introduced in 2004 or 2005. These include ‘worksearch premia’ of £20 per week added to existing benefit levels for some groups out of work, including lone parents and incapacity benefits claimants who engage in active job search, as well as pilots to pay the same groups ‘return to work credits’ at £40 per week for one year when they get into work. In 2005, some couples with children will also be able to get these special credits. This means that, for some people, temporary in-work subsidies will be running alongside more permanent tax credits, blurring the distinction between measures to aid the transition to work and more long-term support in work, as well as potentially creating further complexity.

Goals of policies for in-work support

There are various possible goals of policies for in-work support, which might therefore lead to decisions to use different policy instruments. Some goals are more general and others are more specific to different groups. The more general goals include:

• To **increase the margin between incomes out of work and in work** (which can be achieved by decreasing support out of work, as well as by increasing support in work), in order to increase the likelihood of taking up work. This may be seen as a desirable aim for a variety of different reasons. The traditional economist’s perception is that financial disincentives are a major issue for people contemplating entry to work, and that paid work may be seen as an undesirable activity unless it pays more than ‘leisure’.

• To **decrease poverty in work**, especially when productivity is not considered high enough for an individual to be able to earn a ‘living wage’, and/or employers are not considered competitive enough to be able to afford to pay it. This is why, even if in-work support does not have significant employment effects, this may still not be seen as a problem of ‘deadweight’. Because it is contributing to the desired reduction in poverty, in-work support is not seen to be wasting resources, even if similar numbers would have entered work without it.

• To **help workless households get one earner into employment**, that is, to make work pay for someone with one or more dependants to support; the goal here is to reduce the number of households in which no adult is in work (primarily because of the resulting poverty). This goal could be said to combine the first two above.

• Related to the above is the goal of **facilitating ‘choice’ of family lifestyles**. As the Chancellor of the Exchequer put it in the 2002 Budget speech, when describing the introduction of the new tax credits (including the additional payment of Child Tax Credit for the first year after a baby is born), “... mothers who wish to leave work and be with their children at home but have found it financially difficult to do so will find it easier" (HMT, 2002).

• To **complement compulsion and active labour market policies**: there is 'no excuse' not to take work if offered if the total income package in employment is adequate.

The **more specific policies** may be aimed either at those who are considered to have permanent/long-term labour market disadvantage, or at those whose disadvantage is considered short-term, and policies may differ as a result. The list of policy goals below draws on recent work by Sutherland (personal communication), and by Bennett and Hirsch (2001):

• To **ease the transition into work**: to give temporary additional financial help to overcome the barriers to entry into employment (for example, no/ no recent work experience), that is, as a 'trampoline' into the labour market.

• To **substitute for other mechanisms of social protection**, especially for couples, for example by supporting a couple when one has lost his/her job, or has had to decrease his/her hours/earnings (the 'parachute' rather than 'trampoline' role, as Marsh and McKay (1993) put it in relation to Family Credit, the predecessor of in-work tax credits).

• To **compensate for labour market disadvantage**: for example to subsidise those with low skill levels or those who suffer discrimination (including because of the gender pay gap).

• To **subsidise those who incur additional costs** if they work, for example childcare/other care/some forms of disability.

• To **subsidise those with caring responsibilities or those with disabilities** who therefore cannot work long hours/be flexible/travel to better jobs and so on.

Some limitations of the current approach

Current policy is very much focused on supply-side, rather than demand-side, policies to increase employment. But even within this, the current approach to 'make work pay' contains some tensions on the one hand and does not adequately address some important issues on the other. First, it could be argued that employee rights and security at work, including pension provision, may be just as important as higher income in work – in other words, that (to adapt the government's welfare reform mantra) **'security [at work] for those who can [work]'** may be a crucial part of ensuring 'work for those who can'. The government has improved many rights at work over recent years – including protection against unfair dismissal, increased maternity and parental rights, anti-discrimination legislation, and so on – but with the increasing emphasis on ensuring sustainability of employment and retention of jobs, there may be a case for pressing this agenda further.

Second, it is difficult for in-work support to **promote human capital formation** and training to increase skill levels. The Chancellor's 2003 Pre-Budget Report announced a ‘new deal for skills’, with windfall tax revenue to be redirected towards mandatory skills courses for JSA recipients and basic skills training for people both in and out of work. This requires new policy instruments and targets. The government seems to have recognised the limitations of in-work support in this area.

More generally, this emphasis on **in-work progression** may mean a focus on policies which initially may appear to be opposed to ‘making work pay’. For example, rights to longer maternity/parental leave, and to flexible working, do not immediately make work pay in a direct sense. But they can be an effective means of ensuring that women do not lose out in the longer term in respect of their job progression and lifetime incomes. Arguably there should be more focus on such policies, rather than on those that try to shore up low family income at these times. Finally, research into joint claims for JSA suggests that benefit disincentives are still a significant issue for couples. The **joint assessment of out-of-work benefits** is an important policy problem still to be tackled, and issues of individualisation of benefits are central to this.

Conclusions

Policy choices almost inevitably involve trade-offs between competing goals and successful policy instruments may be seeking to achieve several different outcomes at the same time. But, as we have shown, the ‘making work pay’ policy agenda *is* very complex. With both a range of goals and a range of measures, there is potential for a lack of fit across the various provisions, and for overlaps or even contradictions to arise. For example, there is a tension between the targeting of low-paid individuals and of low-income families/ households with an earner. Short-term measures intended to aid the transition to work are increasingly overlapping with longer-term wage supplementation. There are potential tensions between policies that are static and focused on family poverty and those that are dynamic and focused on individual lifetime income profiles. Thus, as we have described, the new tax credits are static in design (in terms of providing support in the current situation) and calculated on a family basis (rather than based on the individual); but at the same time, there is an increasing interest in improving individual lifetime income profiles, and in progression in work and issues of qualifications and skills.

More conceptual clarity is therefore needed in ‘make work pay’ debates. In particular, we need to differentiate between low gross hourly/weekly pay levels for individuals in work on the one hand, and low disposable income for families with someone in work on the other, and to disaggregate the different groups affected by each. In addition, the Treasury is currently using in-work support through the tax credit system to pursue several different policy objectives. But whether tax credits can bear all this weight is open to debate – they are perhaps more of a blunt instrument than a flexible friend. And with the agenda on work now moving on to new and challenging goals, their limitations also become more apparent.

Table 1: Making work pay: the transition to work

Year	Measure
Dec 1997	Budgeting loans from Social Fund for work-related items
Oct 1998	Linking rule for Incapacity Benefit (to same benefit rate if job fails) extended to one year
1999	Budget Fast track proposed to Disabled Person's Tax Credit for newly disabled
April 1999	Income Support run-on for lone parents entering work (two weeks)
2000 Budget	£100 job grant for job-related expenses on entering work
April 2000	Employment Tax Credit for over 50s long-term unemployed getting low paying job
July 2000	New Deals made 'permanent'
April 2001	'Choices' for lone parents includes option of 'mini-job' with childcare help for a year (and other options)
April 2001	Income Support for mortgage interest: four-week run-on and linking rule
April 2001	Housing Benefit and Council Tax Benefit run-ons will be more automatic
April 2001	£15/week earnings disregard in Income Support increased to £20
Oct 2001	Rapid reclaim of benefits announced: people who took a job that did not work out could go back to benefits more easily
2003 Budget	Eligibility for job grant extended, with £250 rate for those with children. Run-on of Housing and Council Tax Benefit also extended.
2004	Child Tax Credit extended to Jobseeker's Allowance and Income Support claimants (now postponed)

Table 2: Making work pay: measures primarily targeted on individual low-paid workers or families on low incomes with an earner/someone in work

Year	Measure	Target
1998-2000	Earnings Top-up (means-tested in-work benefit) piloted	Household
1998	Maximum childcare costs disregard in Family Credit increased	Household
April 1998	Subsidised jobs for young under New Deal for Young People	Individual
June 1998	subsidised jobs for adult long-term unemployed under New Deal 25+	Individual
April 1999	National Minimum Wage becomes law: £3/hr for 18-21s, £3.60/hr for adults	Individual
April 1999	Introduction of 10% lower income tax rate, replacing 20% lower band	Individual
April 1999	Abolition of NI ‘entry fee’ for employees	Individual
Oct 1999	Working Families Tax Credit (with child support disregarded), and including Childcare Tax Credit	Household
Oct 1999	Disabled Person’s Tax Credit	Household
April 2000	Increases in Child Benefit	Household
June 2000	Increases in Working Families Tax Credit rates for under-16s	Household
June 2000	National Minimum Wage raised from £3/hr to £3.20/hr (18-21s)	Individual
Oct 2000	National Minimum Wage increased from £3.60/hr to £3.70/hr (adults)	Individual
Oct 2000	Campaign to encourage take-up of Working Families Tax Credit	Household
April 2001	Introduction of ‘primary threshold’ (at tax threshold level) for employee NI contributions above lower earnings limit	Individual
Budget 01	Increase in 10% income tax band	Individual
June 2001	Higher Working Families Tax Credit and Childcare Tax Credit	Household
Oct 2001	Adult National Minimum Wage increased 10.8% to £4.10 from £3.70/hr; and youth rate rises from £3.20 to £3.50	Individual
April 2002	Independent Living Funds payment rules allow severely disabled people with job to keep more of their pay	Individual
Oct 2002	Adult National Minimum Wage increased 10p/hr to £4.20 and youth rate to £3.60	Individual
June 2002	Increases in basic credits in tax credits	Household
April 2003	Working Tax Credit: based on 2001/02 income levels initially, but current working circumstances	Household
April 2003	Childcare element of Working Tax Credit	Household

Oct 2003	Adult minimum wage increased to £4.50 and youth rate to £3.80	Individual

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